EMCO LIMITED 1977 ANNUAL REPORT

FINANCIAL SUMMARY

Dollars in thousands except for shares

	1977	1976 Restated
Sales	$ 189,008	178,135
Earnings before extraordinary items	$ 4,873	3,350
Extraordinary items	395	136
Net earnings	$ 5,268	3,486
Per common share:		
Basic earnings:		
Before extraordinary items	$ 1.07	.74
Including extraordinary items	1.16	.77
Fully diluted earnings:		
Before extraordinary items	1.04	.72
Including extraordinary items	1.12	.75
Capital expenditures	$ 4,057	5,439

Annual Meeting

The Annual Meeting of the Shareholders will be held at the Holiday Inn, London, City Centre Tower, 300 King St., London, in the Victoria/Albert Room, at 10:30 A.M. on May 23, 1978.

To Our Shareholders

Emco's earnings in 1977 improved in a most difficult economic environment. Sales advanced from $178 million in 1976 to $189 million in 1977 and net earnings from $3,486,000 (restated) to $5,268,000. On a fully diluted basis, earnings per share increased from 75¢ to $1.12. Reflected in this improvement is a reduction of $550,000 in taxes on income as a result of the recent 3% allowance on Canadian inventories.

A I B controls and continuing inflation

In Canada, which is our major market, the Anti-Inflation Program restricted market growth and directly reduced margins. While wage and price escalations were checked, the long tenure of the program and its application to profits severely curtailed expansion. Your board therefore welcomes the phase-out of this program, hoping of course that the withdrawal is well monitored to avoid the inflationary pressures that preceded the introduction of controls.

Inflation through 1978 will likely average 8% and unemployment at over 8.5%. Within these parameters, neither labour nor management can afford substantial wage increases without disrupting economic recovery. Relative to productivity, labour costs in Canada are already high and place Canadian products in world markets at a disadvantage in competition with products from other countries. The devaluation of the Canadian dollar may give us a fighting chance but it will also fuel inflation. The emphasis must shift to productive job creation and industrial growth, both of which can be best secured in an investment climate that attracts fresh capital. Current returns on capital are at a low ebb and new fiscal measures are necessary to restore investor confidence.

Our commitment to Quebec

Quebec's possible separation from Canada is another concern that is increasingly threatening the national economic scene. The flight of capital and jobs from that Province does not augur well for Canada's economy or unity and it is hoped that the differences between Quebec and the rest of Canada are amicably resolved without seriously rending the economic fabric of our country. Emco's commitment to growth in the Quebec market is unaltered and our recent investment in a new $3.5 million warehouse complex in the Montreal area is proving worthwhile. We shall certainly continue to participate in the opportunities within this market.

Opportunities in the retail faucet market

Development work was completed by our Plumbing and Industrial Group for the introduction of a new faucet line in the retail market. The new "Peerless" single and two handle washerless faucets complement the traditional Emco line, now also fully packaged for off-the-shelf sales to the "do-it-yourselfer".

The retail faucet market has shown phenomenal growth with the growing do-it-yourself trend in North America and with the new Peerless line, we shall greatly increase our faucet sales in this expanding market. Further details appear in the Operations Review of our Plumbing and Industrial Group.

The new construction market might be relatively soft. Housing starts will likely reach an annual rate of 235,000 units compared with 245,724 starts in 1977 and the non-residential sector of construction will at best show slow recovery. On the other hand, the renovation market will be an important growth area for faucet manufacturers.

Opportunities in new technology for oil conservation

The world markets for oil equipment were subdued as political speculation in Europe and the Middle East gave rise to some uncertainties. However, there is now reason to expect greater economic stability.

As the threat of interruptions in oil supply recede and the industrial economies learn to absorb the high cost of oil, the market for Emco Wheaton petroleum handling equipment is bound to expand. During my recent travels through Europe and the U.S.A., I saw growing evidence that environmental and conservation considerations are creating the need for new technology and new products in oil storage and transfer systems. These developments will lead to new opportunities and markets for our Emco Wheaton divisions around the world.

In line with this trend and our planned program for growth, we have made management and organizational changes along with investments in new product development and plant expansion. Now heading the international group is Robert H. Wedgbury who was appointed president of Emco Wheaton (International) Limited last December. At present, based in London, Ontario, he is responsible for the overall direction, management and coordination of our petroleum equipment divisions in England, France, Germany, Japan, Australia, Brazil, the U.S.A. and Canada. Mr. Wedgbury succeeds John G. Beresford who has moved to our U.S. division, Emco Wheaton Inc. in Conneaut, Ohio, as president and general manager. Our managements in Europe have been strengthened to provide better direction in our search for new products and larger markets.

During the year, our largest single investment in expansion was made in Brazil where a new 25,000 sq.ft. plant was built and officially opened in December. Brazil is among the fastest growing economies in the world and our entry into this market, a few years ago, with a manufacturing base, has been very rewarding. Further details appear in the Operations Review of our Engineered Products Group.

Optimistic objectives for 1978

Although the growth in our major markets in Canada and around the world will be relatively soft through 1978, our own objectives are optimistic. Investment in additional manufacturing capacity will continue as will our thrust in market penetration. We are conscious that margins may not hold up but the groundwork for increasing our share in established markets and for establishing our products in new markets will give us commanding positions for continuing advancement.

We have strong management at all levels and a dedicated team of employees around the world. We thank them for their contributions in the past year and look forward to their support in meeting our 1978 objectives. We shall also draw strength from Masco Corporation whose support has been an invaluable asset to Emco.

C. N. Chapman,
President and
Chief Executive Officer

March 10/1978

The Bowmanville Plant expansion will double the manufacturing capacity of Delta Faucet of Canada Limited.

The new steel pipe warehouse in Toronto (Weston) covers a 24,000 sq. ft. area and has grown into a major supply operation in its own right. The man responsible for its growth is Les Douglas, vice-president of Emco Supply, Central Region (in the foreground). Les has been with Emco for 41 years. Apart from directly managing the pipe warehouse and the Toronto and Oshawa Supply branches, he has overall responsibility for 12 other Supply branches in the Central Region.

Review of Operations

PLUMBING AND INDUSTRIAL GROUP

Construction in Canada declined during 1977. Housing starts dropped to 245,724 units, down 10% from 273,203 units in 1976. A sizeable unutilized capacity in many manufacturing industries dampened growth in industrial construction and the commercial and institutional segments as well were subdued by the general climate of restraint in business and government spending.

As a result of the depressed investment climate, the new construction plumbing market was reduced and this produced severe competition. In this setting we opted to maintain our leadership position and, continuing our momentum in market penetration, we achieved an increase in sales. Profits, however, did not keep pace with this gain as margins were affected by extreme competition and the Anti-Inflation Board controls. Since the controls were introduced in October 1975, our General Manufacturing Division, for example, was allowed only one price increase. This was in the fourth quarter of 1977 and the amount allowed was inadequate to cover our increased operating costs.

General Manufacturing Division

A well balanced inventory control program to meet demand helped the General Manufacturing Division to achieve continued sales growth. However, as a result of the Anti-Inflation Board controls, profit margins did not reach satisfactory levels.

The division's regional warehouses in Montreal, Calgary and Vancouver played a key role in moving product swiftly and efficiently to our customers.

The London Plant had a good year in all lines of production: Corona and Sapphire faucets for residential and commercial use; hospital and laboratory faucets; valves, rough brass compression products and other related products.

Significant investments were made in the foundry and other departments of the London Plant for environmental improvements with special emphasis on respiratory, hearing and ear protection. Further improvements are being made in 1978.

Manufacturing operations at our Plastics Plant in Brampton continued to improve and results were ahead of forecast. Some softening in the markets served by plastic fittings is now being experienced but demand will revive as the economy gathers strength.

New products

During the year, production and marketing of the full range of our SUCCESSOR™ waterworks end connection was achieved. This is a patented product and the only one on the market today that offers the installation advantages of a compression end connection without sacrificing the pull-out resistance of a flared connection. User response has been most enthusiastic and we are convinced that SUCCESSOR™ will become the standard in the waterworks field.

Another new product development is the PLUGGER™, also now patented. A bath stopper, it offers fingertip operation in a rotary action. It incorporates an endless cam design and all parts, except the spring, are non-metallic. The PLUGGER™ has been introduced to the Canadian and U.S. markets and inquiries are now coming from Europe. The U.S. introduction was facilitated by Masco Corporation.

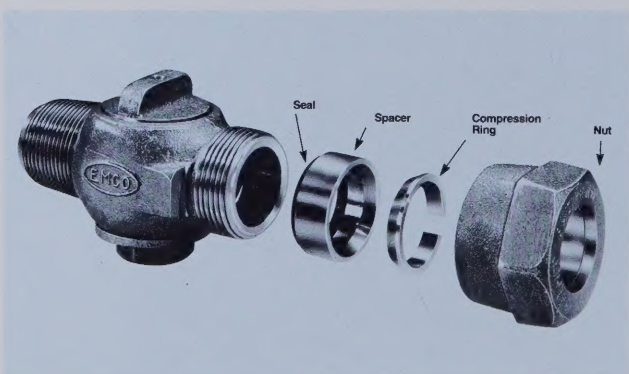
Other new products include an ABS plastic tool, for use by the plumbing trade, which simplifies installation of bath waste outlets. An important advance in new products is a redesigned, frost-proof wall hydrant with lockshield protection. This wall hydrant is not only more compact, but also simplifies installation for the plumber.

The Tingle King Showerhead, introduced last year, continues to outsell all other Canadian made showerheads.

Delta Faucet of Canada

This wholly owned subsidiary made great strides in market penetration and achieved its optimistic 1977 sales targets for both DELTA single handle and DELEX two handle faucets. The sales staff for Ontario was increased, extending considerably Delta's reach in this territory.

During the year the Bowmanville Plant undertook the manufacture of several products hitherto made only in the U.S.A. Operating to projected levels of capacity, the plant's strength increased from 48 employees in December, 1976 to 77 employees in December, 1977.



As a reflection of management's confidence in the continuing sales growth of Delta Faucet of Canada, a second stage of plant expansion is now underway.

Delta Faucet of Canada is the only Canadian company manufacturing a full line of single and two handle washerless faucets.

The ready acceptance of these outstanding Canadian manufactured DELTA and DELEX washerless faucets by the industry, reinforces our decision to double the manufacturing capacity of the Bowmanville Plant.

CCTF

Canadian Clyde Tube Forgings Limited again maintained its market share in a difficult market for its product line of welding fittings and flanges in carbon steel, stainless steel, and various alloys. The volume of capital construction in the marine, mining, petro-chemical, pulp and paper and other industries, which are major users of the products of CCTF, remained substantially off in Canada during 1977 and price competition from both domestic and foreign competitors continued to be extreme.

During 1977 CCTF streamlined its operations and introduced several important cost reduction programs. Inventory levels are now at a satisfactory operating level and CCTF is well prepared to participate fully and profitably in the stronger market for its products in 1978.

The CCTF branch in Seattle, Washington, established in 1976, has gained a firm position in the Pacific Northwest market and will make a meaningful contribution to CCTF's performance in 1978.

Emco Supply

1977 was a good year for Emco Supply as sales to residential construction advanced substantially. Basically, this speaks for our wholesale operation's growing strength and greater penetration in the residential part of the plumbing market.

TOP LEFT – We expect Emco's "Successor" end connection to become the standard in the waterworks field. It combines the security of a flared connection with the convenience of a compression fitting. The picture of the car slung by a "Successor" connection was used in an advertisement to dramatize the connection's strength.

BOTTOM LEFT – An Emco main stop with "Successor" compression end connection.

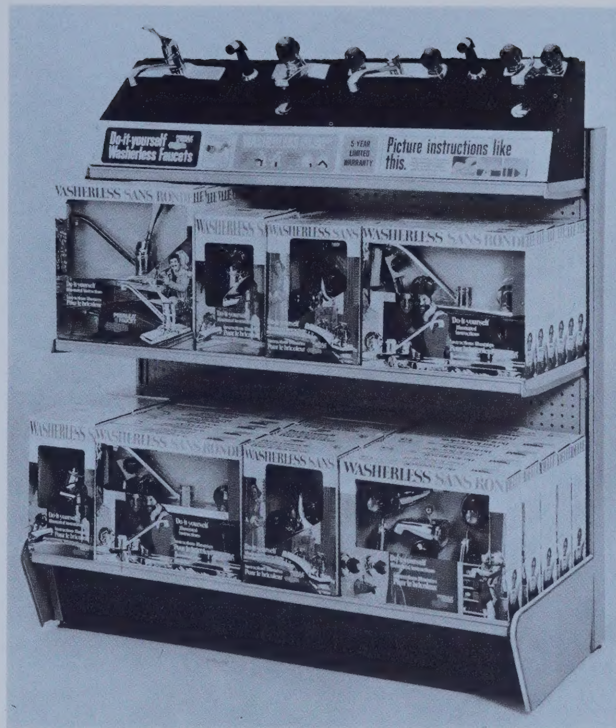
The Montreal branch moved to its new warehousing complex in Lachine, Quebec, in the winter months of 1977. This is the largest warehouse in the industry in Canada and it has been designed for highly efficient product flow and customer service. The new complex represents a major capital investment in the Province of Quebec and it is indeed the flagship of Emco Supply's eastern regional wholesale operations.

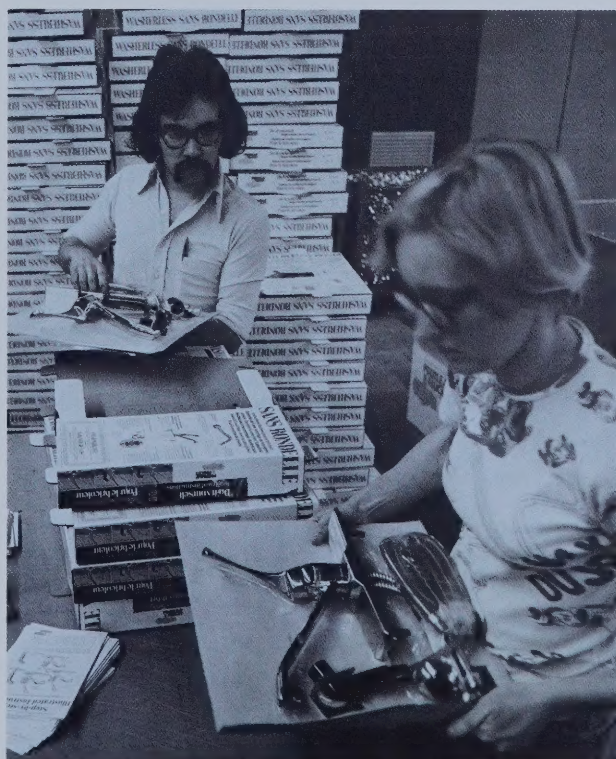
A new warehouse in Grande Prairie, Alberta, is now under construction and will be open for business in May. The Lethbridge warehouse has been upgraded and extended with a 10,000 sq. ft. addition. Construction has started on a new and larger facility for our Peterborough branch.

A new modern warehouse for steel pipe has been built in Toronto to accommodate our continually growing pipe sales volume. The Supply network now numbers 35 outlets across Canada.

In the last few years the division has been broadening its customer base and is therefore now less dependent on "new housing" swings. Prospects for 1978 look good and the division expects to again achieve growth in sales as well as earnings.

Seeking new markets
During 1977, the General Manufacturing Division prepared to enter the Canadian retail faucet market. Our product offering will be Emco's retail line of faucets from the London Plant and the new Peerless single and two handle washerless faucets from the Bowmanville Plant. The Peerless line will be marketed by Peerless Faucet Company, a new division of Delta Faucet of Canada. Between the Emco and Peerless line we will very comprehensively cover the price range in the retail faucet market. Both lines are attractively packaged and contain complete installation instructions for off-shelf sales through chain and independent hardware and department stores.





TOP RIGHT – The new Peerless line of single and two handle washerless faucets is geared to the growing do-it-yourself retail market.

BOTTOM RIGHT – From product design to packaging, the focus is on the do-it-yourselfer. Step-by-step illustrated instructions are included to simplify installation and emphasize the theme: "You can do it too."

The Emco line of faucets for the retail market is now specially packaged to promote off-shelf sales through chain and independent hardware and department stores. Between the Emco and Peerless lines we will comprehensively cover the price range in the retail faucet market.

The growing do-it-yourself trend in North America is a new factor in the replacement market for faucets. The Peerless experience in the U.S.A. and our own marketing studies point to exciting opportunities ahead in Canada and we are determined to claim a good part of this rapidly expanding market. This will broaden our total marketing base and will help to even out the cyclical bumps in our faucet sales.

Overall outlook for plumbing and industrial products

The outlook for new construction is relatively soft. Housing, which is a prime market for our products, is faced with a record high unsold inventory. However, as supply and demand readjust to more realistic levels, new housing starts, by mid year, are expected to pick up at an annual rate of 235,000 units.

The renovation market will be an important target through and beyond 1978. In 1977 about 15,000 older homes were rehabilitated, while the potential is estimated at 2,500,000. With land costs high and replacement value beyond the reach of many, the Central Mortgage and Housing Corporation is likely to make available substantial funds to this large potential market. The continuing lack of interest in rental construction properties will remain through 1978 as we are likely to have some form of rent control for a while.

The non-residential sector of construction is likely to show a slow recovery in the immediate future. Economic uncertainties still persist and the high cost of construction, labour contract negotiations and energy and environmental considerations are additional constraints. Economic growth will be therefore slow and inadequate to sustain major industrial expansion in 1978. The non-residential segments, dependent on government spending, are in for a "non-growth" year as provincial and municipal governments continue to apply spending restraints.

While the overall picture is subdued, there will be scattered pockets of growth in Ontario, the Maritimes, Alberta and British Columbia. Inter-provincial population transfers could create demand in these areas for housing. Alberta will also experience growth in the manufacturing segment and Ontario in both manufacturing and service segments.

Our 1978 objectives are clear. We shall continue our thrust in market penetration, expand our product base, reach for new markets and extend our financial, technological and managerial capabilities to higher levels. In the balance, this will increase sales and improve our earnings. We certainly look to 1978 with hope and increasing confidence.

Review of Operations
ENGINEERED PRODUCTS GROUP

High oil prices, declining world oil consumption, a squeeze on corporate profits and the fear of unpredictable oil supplies discouraged major investment in oil distribution. This world scenario sharply contrasts with the oil industry's growth through the sixties and up to the winter of 1973 when the Organization of Petroleum Exporting Countries quadrupled oil prices. The emphasis has since shifted from consumption to conservation and from distribution to exploration.

Our petroleum handling equipment is primarily used in the distribution of the product and the market for this portion of our product line was weak. As a result, competition was keen and our margins dropped. The vapor recovery nozzle market, the one bright spot that we expected to unfold a whole new opportunity in the U.S.A., was bogged down due to legislative delays. However, within these constraints, our operating divisions around the world advanced their positions in their markets.

The Americas
The size of the available market in Canada decreased but sales of our Canadian division stayed close to the 1976 level.

Profits were only slightly lower due to increased costs that could not be recovered through price increases.

In the U.S.A., continuing delays in the implementation of Stage II vapor recovery legislation related to service station nozzles affected the sales of our division in Conneaut, Ohio. The Conneaut plant has a substantial investment in the full range of vapor recovery nozzles and it is still expected that we will have a significant opportunity when the market for this equipment opens, following the adoption of the necessary legislation.

The Marine Loading Arm Division in Gulfport, Mississippi, had a good year and met its financial objectives. We expect continuing growth as demand improves for bulk shore to ship and ship to shore transfer equipment in North America.

Our Brazilian subsidiary's new plant was officially opened in December. Located in suburban Rio de Janeiro, the plant has an area of 25,000 sq. ft. In addition to the regular Emco Wheaton product lines, this division represents several other North American manufacturers in Brazil and also manufactures one product under an arrangement with a U.S. company.

Despite high inflation and continuing currency devaluations, the net income of this subsidiary was satisfactory and reflects the fine performance of our local management group.

Our Brazilian subsidiary's new plant covers 25,000 sq. ft. In addition to the regular Emco Wheaton lines, this division represents several other North American manufacturers.

Europe
The domestic markets of our divisions in England, France and Germany were weak but sustained efforts made by all three divisions paid off in record export sales. Our Kirchhain plant in Germany shipped a large order for marine arms to East Germany. However, surplus capacity in the oil equipment industry led to pressures on margins and profits consequently declined in all three divisions.

Major capital investments were made for the replacement of the computer system in England and for the completion of a plant expansion in Germany. Both divisions carried forward a substantial backlog of orders and we expect improved sales and margins through 1978.

The prospects for our division in France are less clear. Clouded by the country's general elections in March, investments have slowed down and the franc is now under pressure. More stable conditions are expected once the political uncertainties are resolved.

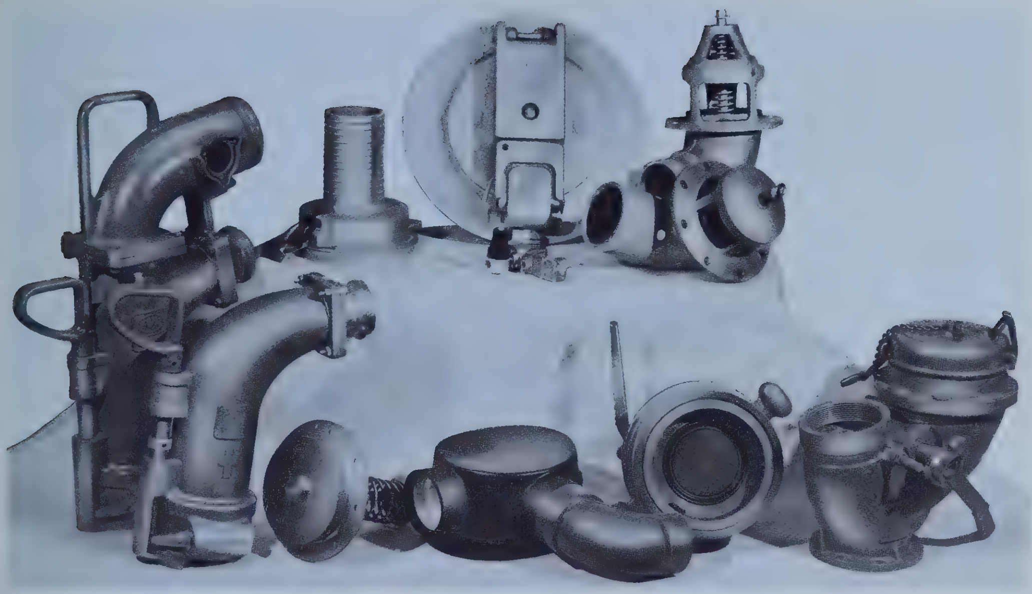
Far East and Australia
Our division in Japan, which has had a successive record of growth, showed a drop in sales and earnings for the second year in a row, reflecting a continuing slowdown in that country's economy.

The Australian division increased sales and profits in 1977. This division expanded its product offering through manufacturing licences and exclusive distribution rights for products outside the Emco-Wheaton range. These arrangements contributed significantly to improved sales.

Product Development
The range of swing joints for all fluid handling applications is one of our most important product lines and during the year a new Teflon-lined joint was jointly developed by our division in Germany and our Research and Development Centre in England. This product is for use in the chemical industry. Further development work is also continuing for cryogenic (temperatures below -100C) applications.

TOP LEFT – Four 16" (400 mm) B4000 Emco Wheaton hydraulic marine arms at the Orkney Islands in Scotland are used in the transfer of off-shore North Sea crude from tankers to the refinery.

BOTTOM LEFT – Another Emco Wheaton marine arm installation in Louisiana, U.S.A. These arms were made at our plant in Gulfport, Mississippi.



Our plant in Conneaut, Ohio continues to make significant advances in the development and manufacture of components for the various phases of vapor recovery. The fittings illustrated are for tank trucks and service station installations.

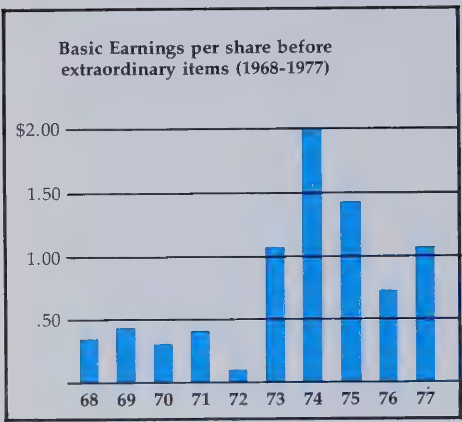
In the vapor recovery field, our U.S. division in Conneaut, Ohio, has developed a new second generation vapor recovery nozzle suitable for use at regular, as well as self-serve, service stations. The new A3003 nozzle incorporates a NO SEAL/NO FLOW valve and offers extremely efficient recovery rates. This nozzle has been field-tested extensively in the California area.

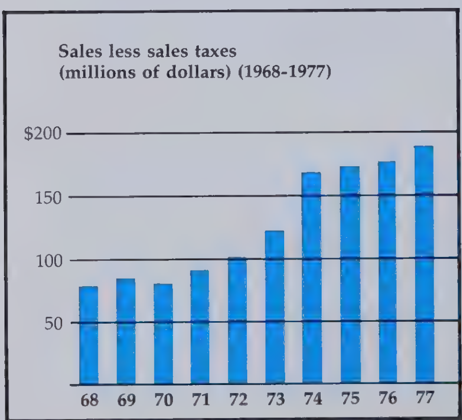
The Future
Group sales are directly linked to new investments related to the distribution of petroleum products and all indications are that capital spending by major oil companies will begin to grow modestly in this area through 1978.

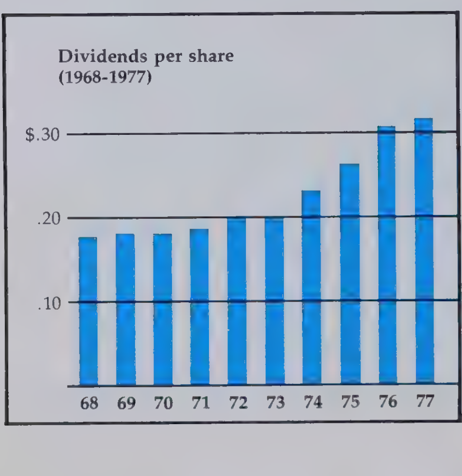
The long term prospects are more optimistic. Industrialized countries are learning to absorb higher energy costs while at the same time oil producing countries are beginning to stabilize price increases at or below the inflation rate. In addition, the gloom and doom view in respect to oil resources is beginning to recede in favour of a more realistic view as new oil discoveries are made and new reserves are established and brought on stream.

Environmental and conservation concerns are exerting pressures for new technology which should result in new opportunities. Vapor recovery systems are a prime example. Once the U.S. program for these recovery systems gets underway, we expect other countries to follow. These developments are promising and while we don't expect a return to the boom of the sixties, we do forsee a measured market expansion.

Our efforts in the next few years will be towards development of new markets for products developed in the past three years and for developing new products for markets that we have not yet entered. The overall thrust will be towards reaching a wider market with a broader product base. We have developed engineering and marketing resources to pursue these objectives successfully and unquestionably we are well prepared to seize every opportunity in the market. Overall, we expect to improve on our 1977 performance.







Emco Limited and Subsidiaries

Ten Year Financial Summary

	1977
SALES, LESS SALES TAXES	$189,008
CHANGES IN FINANCIAL POSITION	
Funds provided:	
Operations	$ 7,043
Extraordinary items, net	147
Increase in long-term debt	—
Issue of common shares:	
For cash	—
On conversion of 7% debentures	—
Proceeds on disposal of property and plant	545
Total funds provided	7,735
Funds used:	
Property, plant and equipment	4,057
Decrease in long-term debt:	
Principal	1,107
Foreign currency translation adjustment	(450
Redemption of second preference shares	—
Dividends on second preference shares	—
Dividends on common shares	1,453
Other, net	315
Total funds used	6,482
Increase (decrease) in working capital	$ 1,253
Working capital at December 31	$ 49,085
COMMON SHARE RESULTS	
Basic earnings:	
Before extraordinary items	$ 1.07
Including extraordinary items	1.16
Fully diluted earnings:	
Before extraordinary items	1.04
Including extraordinary items	1.12
Book value at December 31	10.58
Dividends paid	.32
Return on shareholders' equity at January 1 (based on earnings before extraordinary items)	% 11.0

1976	1975	1974	1973	1972	1971	1970	1969	1968
178,135	175,834	172,550	130,329	100,542	95,926	83,810	89,380	83,399
5,083	8,621	10,054	5,235	1,673	2,774	2,267	2,791	2,509
(8)	205	256	—	—	—	—	1,648	—
15,056	633	—	280	—	6,000	5,000	—	—
4	53	—	—	—	41	91	2	33
101	7	4,890	—	34	—	—	—	—
272	55	152	1,049	427	—	24	60	169
20,508	9,574	15,352	6,564	2,134	8,815	7,382	4,501	2,711
5,439	4,096	3,054	2,984	2,594	1,791	939	1,768	1,928
900	643	6,329	82	153	1,539	3,577	637	253
16	(9)	2	(1)	4	4	28	1	5
—	—	—	—	—	—	442	239	297
—	—	—	—	—	—	7	17	25
1,452	1,265	998	756	756	723	689	687	686
448	(596)	(254)	140	231	201	231	26	(37)
8,255	5,399	10,129	3,961	3,738	4,258	5,913	3,375	3,157
12,253	4,175	5,223	2,603	(1,604)	4,557	1,469	1,126	(446)
47,832	35,579	31,404	26,181	23,578	25,182	20,625	19,156	18,030
.74	1.46	2.00	1.12	.14	.45	.33	.47	.39
.77	1.51	2.08	1.17	.17	.45	.33	.91	.39
.72	1.40	1.91	.91	.14	.43	.33	.47	.39
.75	1.44	1.97	.95	.17	.43	.33	.91	.39
9.74	9.29	8.06	6.15	5.20	5.27	5.02	4.88	4.15
.31	.27	.23	.20	.20	$.18\frac{3}{4}$	$.18\frac{1}{3}$	$.18\frac{1}{3}$	.18
8.0	18.1	31.7	21.5	2.7	8.9	6.7	11.3	10.0

NOTE:

Amounts shown above are thousands of dollars with the exception of data under the heading common share results.

Emco Limited

Consolidated Balance Sheet

December 31, 1977
with comparative figures for 1976

Assets	1977	1976 Restated
Current assets:		
Cash	$ 1,233,946	1,027,447
Marketable securities, at cost (quoted value $395,068; 1976, $172,218)	341,458	141,833
Accounts receivable, less allowance for doubtful accounts ($2,036,044; 1976, $1,643,300)	25,849,233	24,495,098
Inventories at the lower of cost or net realizable value (note 2)	52,820,622	50,737,099
Prepaid expenses	1,052,943	940,311
Total current assets	81,298,202	77,341,788
Long-term receivables	667,452	280,151
Property, plant and equipment, at cost less depreciation (note 3)	23,080,977	20,990,895
Unamortized debt discount and expense	357,203	400,331
	$ 105,403,834	99,013,165

Liabilities and Shareholders' Equity	1977	1976 Restated
Current liabilities:		
Bank and other short-term indebtedness	$ 12,390,187	13,420,656
Accounts payable and accrued expenses	15,312,942	13,822,392
Dividends payable	363,185	363,185
Current portion of long-term debt	761,177	400,751
Income and other taxes payable	3,384,932	1,502,203
Total current liabilities	32,212,423	29,509,187
Deferred income taxes	1,294,811	846,449
Long-term debt (note 4)	23,580,937	24,238,161
Minority interest in subsidiary companies	304,692	223,526
Shareholders' equity:		
Capital stock, common shares (note 5)	5,630,810	5,630,810
Retained earnings	42,380,161	38,565,032
Total shareholders' equity	48,010,971	44,195,842
	$ 105,403,834	99,013,165

See accompanying notes to consolidated financial statements.

On behalf of the Board: **C. N. Chapman,** Director
J. W. Adams, Director

Emco Limited

Consolidated Statement of Earnings

Year ended December 31, 1977
with comparative figures for 1976

	1977	1976 Restated
Sales, less sales taxes:		
Plumbing and Industrial Group	$ 157,706,875	150,386,201
Engineered Products Group	31,300,816	27,749,044
	$ 189,007,691	178,135,245
Operating profit after minority shareholders' interest but before the undernoted items	$ 12,018,415	12,157,463
Investment income	51,110	20,919
Foreign currency translation gain (loss) (note 1)	989,406	(348,725)
Non-recurring recovery of purchase commissions	509,387	—
	13,568,318	11,829,657
Deduct:		
Depreciation	1,775,215	1,545,516
Interest on bank and other short-term advances	1,448,239	3,019,224
Interest on long-term debt	2,150,995	853,489
Earnings before taxes on income	8,193,869	6,411,428
Taxes on income (note 6):		
Current	3,039,000	2,770,000
Deferred	282,000	291,000
	3,321,000	3,061,000
Earnings before extraordinary items	4,872,869	3,350,428
Extraordinary items (note 7)	395,000	136,000
Net earnings	$ 5,267,869	3,486,428
Earnings per common share:		
Basic:		
Before extraordinary items	$ 1.07	.74
Extraordinary items	.09	.03
Including extraordinary items	$ 1.16	.77
Fully diluted:		
Before extraordinary items	$ 1.04	.72
Extraordinary items	.08	.03
Including extraordinary items	$ 1.12	.75

See accompanying notes to consolidated financial statements.

Emco Limited

Consolidated Statement of Retained Earnings

Year ended December 31, 1977
with comparative figures for 1976

		1977	1976 Restated
Amount at beginning of year			
As previously reported	$	38,250,247	36,285,681
Adjustment relating to change in accounting for foreign currency translations (note 1)		314,785	244,641
As restated		38,565,032	36,530,322
Add net earnings		5,267,869	3,486,428
		43,832,901	40,016,750
Deduct dividends		1,452,740	1,451,718
Amount at end of year	$	42,380,161	38,565,032

See accompanying notes to consolidated financial statements.

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Emco Limited as at December 31, 1977 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles which, except for the change in the method of accounting for foreign currency translation as described in note 1 to the consolidated financial statements, were applied on a basis consistent with that of the preceding year.

PEAT, MARWICK, MITCHELL & CO.
Chartered Accountants

London, Canada
February 20, 1978

Emco Limited

Consolidated Statement of Changes in Financial Position

Year ended December 31, 1977
with comparative figures for 1976

	1977	1976 Restated
Funds provided:		
Operations	$ 7,042,616	5,083,576
Extraordinary items, net	147,000	(8,400)
Issue of notes	—	15,055,500
Issue of common shares:		
Conversion of 7% debentures	—	100,890
Exercise of options and warrants	—	4,220
Proceeds on disposal of property and plant	545,495	272,558
Other	81,166	6,669
Total funds provided	7,816,277	20,515,013
Funds used:		
Property, plant and equipment	4,056,564	5,439,139
Decrease in long-term debt:		
Reduction of principal	1,107,465	900,412
Foreign currency translation adjustment	(450,241)	15,615
Net decrease	657,224	916,027
Dividends on common shares	1,452,740	1,451,718
Other	396,571	454,755
Total funds used	6,563,099	8,261,639
Increase in working capital	$ 1,253,178	12,253,374
Working capital at end of year	$ 49,085,779	47,832,601

See accompanying notes to consolidated financial statements.

Emco Limited

Notes to Consolidated Financial Statements

December 31, 1977

(1) Accounting policies:

The following is a summary of certain significant accounting policies followed in the preparation of the consolidated financial statements.

Principles of consolidation: The accompanying financial statements consolidate the accounts of all subsidiary companies. All material intercompany balances and transactions have been eliminated.

Foreign currency transactions: The accounts of the subsidiary companies located outside Canada have been translated to Canadian dollars as follows: current assets, current liabilities and long-term debt – at rates current at the year end; fixed assets – at rates current on dates of acquisition; accumulated depreciation and related provisions against income – on the basis of dollar value of related assets; and operating income and other expenses – at average rates for the year.

Prior to January 1, 1977, gains resulting from such translation practices were deferred and losses in excess of previously deferred gains, accounted for by country, were charged to earnings. Effective January 1, 1977, gains and losses resulting from such translation practices are reflected in the statement of earnings. The treatment of gains and losses is in accordance with the recommendations of the Financial Accounting Standards Board as outlined in Statement 8. Previous years' financial statements have been restated to give effect to this change in accounting practice.

The investment in consolidated net assets at December 31 was geographically distributed approximately as follows:

	1977	1976
Canada and United States	**$ 40,453,000**	38,081,000
Europe	**5,049,000**	4,058,000
Japan and Australia	**1,965,000**	1,517,000
Brazil	**544,000**	540,000

Depreciation: Depreciation is generally provided on a straight line basis over the estimated useful lives of the assets. Depreciation rates are as follows: buildings 2.5% and 5%; roadways 10%; machinery and equipment 10% and 20%.

Amortization: The debt discount and expense on the long-term debt is being amortized over the term of the debt in proportion to the principal amount outstanding during each year. The amount amortized is included in interest on long-term debt expense in the statement of earnings.

Research and development expenses: Costs associated with research and development of new products and improvements to existing products are expensed as incurred.

Earnings per share: Earnings per share are calculated using the weighted daily average number of shares outstanding.

Fully diluted earnings per share are calculated on the assumption that any options and warrants outstanding at the end of the year were exercised at the beginning of the year; and that funds derived therefrom had been used to reduce bank indebtedness and related interest costs. The interest deducted less related income taxes was $104,000 (1976, $108,000).

(2) Inventories:

	1977	1976
Raw materials	**$ 2,894,665**	2,322,727
Work in process	**14,152,942**	11,760,033
Finished goods	**38,020,977**	36,697,907
	55,068,584	50,780,667
Less progress billings	**2,247,962**	43,568
	$ 52,820,622	50,737,099

(3) Property, plant and equipment:

	1977	1976
Buildings and roadways	**$ 19,209,959**	17,698,658
Machinery and equipment	**16,153,992**	14,948,983
	35,363,951	32,647,641
Less accumulated depreciation	**15,819,477**	15,120,959
	19,544,474	17,526,682
Land	**3,536,503**	3,464,213
	$ 23,080,977	20,990,895

(4) Long-term debt:

	1977	1976
Emco Limited:		
5¾% sinking fund debentures due June 15, 1985	**$ 3,720,000**	4,057,000
9¾% sinking fund debentures due July 15, 1990	**4,635,000**	4,810,000
Note due May 19, 1978 (U.S. $5,000,000)	**5,468,500**	5,042,500
Note payable in instalments to December 16, 1986	**10,000,000**	10,000,000
Interest on the above notes will change from time to time in relation to the lender's cost of borrowing. The interest rates at December 31, 1977 were 8.2% and 9.3% respectively.		
Subsidiary Companies:		
6% mortgage note payable in monthly instalments of principal and interest of U.S. $3,583, due August 1, 1986 (U.S. $287,026)	**313,919**	314,637
9% mortgage payable due March 10, 1977	—	202,243
9% mortgage payable in monthly instalments of principal and interest of $2,311, due October 1, 1989	**204,695**	212,532
	24,342,114	24,638,912
Less amounts due within one year included with current liabilities	**761,177**	400,751
	$ 23,580,937	24,238,161

The U.S. $5,000,000 note due May 19, 1978 has not been included in current liabilities as the company has arranged to borrow U.S. $5,000,000 on May 19, 1978 which loan will mature on October 22, 1979.

Long-term debt falling due or to be met out of sinking fund payments in the five years ending December 31, 1982, after taking into account the principal amount of debentures repurchased by the company which have been tendered to the trustee in respect of future sinking fund payments, aggregates $761,177 in 1978; $6,278,402 in 1979; $1,040,826 in 1980; $1,156,958 in 1981 and $1,220,320 in 1982.

(5) Capital stock:

Authorized, issued and outstanding:

	Number of shares		
	Authorized	Issued and Outstanding 1977	Issued and Outstanding 1976
First preference shares with a par value of $100 each	150,000	—	—
3% cumulative redeemable second preference shares with a par value of $10 each	61,600	—	—
Common shares without par value	12,000,000	**4,539,814**	4,539,814

Share options: At December 31, 1977, 188,550 common shares had been reserved for issuance under share option plans for certain key executives. There were no options outstanding at December 31, 1977.

Share purchase plan: During 1968, a share purchase plan was approved whereby the employees of the company and its subsidiaries (excluding officers and directors of Emco Limited) may purchase common shares of the company. As at December 31, 1977, there were 128,145 shares available for future subscriptions. There were no transactions during 1977.

Dividend restrictions: The trust deeds relating to the debentures each contain provisions whereby dividends may not be declared or paid, other than stock dividends, and the company may not effect any reduction to its capital stock which would reduce net current assets and shareholders' equity (as therein defined) below certain levels. At December 31, 1977 the net current assets and shareholders' equity (as so defined) were substantially in excess of minimum levels. Particulars as to a further dividend restriction are set out in note 10.

Conversion privilege: There were 253,450 common share purchase warrants outstanding at December 31, 1977 entitling the holder to purchase one new common share for each warrant held. The warrants expire on August 1, 1980 and the exercise price for each warrant is $8.93.

The company has convenanted to reserve a sufficient number of common shares to be available for issue upon exercise of the common share purchase warrants.

(6) Taxes on income:

The effective income tax rate on the consolidated statement of earnings is 6.7% ($550,000) less than the comparable tax rate for the prior year as a result of the introduction of the 3% inventory allowance by Canadian taxation authorities.

The potential income tax benefits associated with operating losses of certain subsidiaries in prior years are not recognized in the accounts. These operating losses, which aggregate approximately $884,000 are available to reduce taxable income which might otherwise be reported in certain future years. The availability of these losses for that purpose expires as to $141,000 in 1979; $332,000 in 1980; $383,000 in 1981 and $28,000 in 1982.

There are also unused investment and foreign tax credits amounting to approximately $167,000 which are available for future deduction.

(7) Extraordinary items:

	1977	1976
Gain on sale of property and plant net of income taxes of $106,000 (1976 - $33,000)	**$ 248,000**	111,400
Reduction in income taxes of subsidiary companies from the application of losses carried forward	**147,000**	183,600
Settlement of lawsuit net of income taxes of $135,000	—	(159,000)
	$ 395,000	136,000

(8) Remuneration of directors and senior officers:

The aggregate direct remuneration paid or payable by the company to directors and senior officers was $697,000 for the year ended December 31, 1977 (1976, $625,000).

(9) Pension plans:

The company has no significant liability for past services under its pension plans.

(10) Anti-Inflation Act:

The company and certain of its Canadian subsidiaries are subject to the Anti-Inflation Act which provides, as from October 14, 1975, for restraint on profit margins, compensation to employees and dividends to shareholders. Management believes that the companies have complied with the provisions of this Act.

Under this Act, dividends on common shares of the company for the twelve months to October 13, 1978 cannot exceed $2,315,000.

Directors — Emco Limited

John W. Adams, F.C.A.	*Executive Vice-President and Treasurer, Emco Limited* *London, Ontario*
C. Norman Chapman	*President and Chief Executive Officer, Emco Limited* *London, Ontario*
Frederick L. Donnell	*President, Plumbing Products Division,* *Masco Corporation, Indianapolis, Ind.*
W. Harold Evans	*Retired Chairman, Honeywell Limited* *Toronto, Ontario*
Peter J. Ivey	*President, Cambarex Investments Limited* *London, Ontario*
Frederick W. P. Jones	*Business Consultant* *London, Ontario*
Wayne B. Lyon	*Executive Vice-President, Masco Corporation* *Taylor, Michigan*
Ralph S. MacLean	*Vice-President,* *Plumbing and Industrial Group, Emco Limited* *London, Ontario*
Richard A. Manoogian	*Chairman of the Board, Emco Limited* *President, Masco Corporation* *Taylor, Michigan*
Edwin C. Phillips	*President,* *Westcoast Transmission Company Limited* *Vancouver, British Columbia*
Arman R. Simone	*President,* *Simone Corporation* *Westport, Connecticut*
Robert W. Stevens, Q.C.	*Partner,* *Blake Cassels and Graydon* *Toronto, Ontario*
David B. Weldon	*Chairman of the Board,* *Midland Doherty Limited* *Toronto, Ontario*

Officers

Richard A. Manoogian	*Chairman of the Board*
C. Norman Chapman	*President and Chief Executive Officer*
John W. Adams, F.C.A.	*Executive Vice-President and Treasurer*
Ralph S. MacLean	*Vice-President, Plumbing & Industrial Group*
Stuart F. Smith	*Vice-President, General Manufacturing Division*
A. Robert Martin, F.C.A.	*Secretary*
W. Wesley DeShane, C.A.	*Comptroller and Assistant Secretary*

Transfer Agents and Registrars

The Royal Trust Company
Toronto, Montreal and Winnipeg (5³/₄% debentures);
Toronto, Montreal, Winnipeg, Regina, Calgary and Vancouver
(common shares and common share purchase warrants)
The Canada Trust Company
Toronto, Montreal and Winnipeg (9³/₄% debentures)

Auditors

Peat, Marwick, Mitchell & Co.
London, Ontario

Plumbing and Industrial Group

From the four plants and 34 branches across Canada that make up the Plumbing and Industrial Group emerge more than 10,000 different plumbing and heating products ranging from relatively simple faucets to industrial components made to rigid specifications. The Supply operation of this group with a coast-to-coast network distributes products made by Emco and its subsidiary companies. In addition, it also handles complementary product lines made by other manufacturers.

DIVISIONS

Emco Supply

Barrie	Oshawa
Belleville	Ottawa
Calgary	Peterborough
Dryden	Prince George
Edmonton	Quebec
Grande Prairie	Regina
Guelph	Saint John
Halifax (Dartmouth)	Sault Ste. Marie
Hull	Saskatoon
Kitchener	Sherbrooke
Lethbridge	St. Catharines
London	St. John's
Medicine Hat	Sudbury
Moncton	Terrace
Montreal (Lachine)	Toronto (Weston)
North Bay	Ville de Brossard
	Windsor
	Winnipeg

General Manufacturing
– London Factory, London, Canada – manufacturer of plumbing, heating and industrial piping products for sale to distributors.

– Emco Plastics Limited, Brampton, Ontario – manufacturer of plastic plumbing and piping components.

– Delta Faucet of Canada Limited, Bowmanville, Ontario – manufacturer of Delta, Delex and Peerless faucets.

CCTF
Toronto, Ontario – supplier of steel welding fittings for industry.
Branches – Vancouver, Seattle (Washington)

Divisional Operating Executive

J. J. Wareham	*Eastern Regional Manager, Emco Supply*
W. L. Douglas	*Vice-President, Central Regional Manager, Emco Supply.*
W. M. Eager	*Western Regional Manager, Emco Supply*
D. J. Hackett	*Vice-President and General Manager, CCTF*
P. Penna	*General Manager, Emco Plastics Limited*
G. D. Thompson	*Vice-President and General Manager, Delta Faucet of Canada Limited*

Engineered Products Group

The Engineered Products Group manufactures and distributes highly engineered fluid handling equipment used in oil and petrochemical industries around the world. The products, offered under the Emco Wheaton name, range from service station nozzles and fleet fueling systems to tank truck loading assemblies, marine loading arms and bunkering units to vapor recovery systems. These Emco Wheaton products reach world markets through plants in England, France, West Germany, Japan, Australia, Brazil, the U.S.A. and Canada. Supporting the manufacturing operations is a Research and Development Centre at Margate in England.

DIVISIONS

Research and Development Centre Margate, England

Wheaton Australia Pty. Limited Sydney, Australia

Emco Wheaton Industria E Commercio S.A. (84% owned) Rio de Janeiro, Brazil

Emco-Wheaton Limited Toronto, Canada; Branches – Montreal, Calgary, Vancouver (Burnaby)

Emco Wheaton U.K. Limited Margate, England

Emco Wheaton S.A. Paris, France

Emco Wheaton GmbH (76% owned) Kirchhain, West Germany

Emco Wheaton (Japan), Limited Yokohama, Japan

Emco Wheaton Inc. – Conneaut, Ohio and Gulfport, Mississippi, United States

Divisional Operating Executives

R. H. Wedgbury	*President, Emco Wheaton (International) Limited, London, Canada*
A. R. Martin	*Vice-President, Emco Wheaton (International) Limited, London, Canada*
R. F. Howard	*Vice-President and Group Marketing Director, Emco Wheaton (International) Limited, European Office, Canterbury, England*
Dr. K. A. Upton	*Director, Emco Wheaton Research & Development Centre, Margate, England*
R. J. Treble	*Managing Director Wheaton Australia Pty. Limited, Sydney, Australia*
P. S. Seybold	*General Manager, Emco Wheaton Industria E Comercio S.A.*
R. M. Clark	*General Manager, Emco-Wheaton Limited, Toronto*
W. F. Shutler	*Managing Director, Emco Wheaton U.K. Limited*
G. Herd-Smith	*General Manager, Emco Wheaton S.A.*
W. Buchmueller	*General Manager, Emco Wheaton GmbH*
G. Teramura	*General Manager, Emco Wheaton (Japan), Limited*
J. G. Beresford	*President, Emco Wheaton Inc., Conneaut, Ohio, U.S.A.*
T. F. J. Rose	*Vice-President, General Manager, Emco Wheaton Inc., (Marine Loading Arm Division) Gulfport, Mississippi, U.S.A.*

EMCO LIMITED
BOX 5300, LONDON, CANADA, N6A 4N7

Subsidiaries
Australia/Brazil/Canada/France/Great Britain
Japan/United States/West Germany